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No. 92-1751

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

ALCAN ALUMINUM CORPORATION,
Petitioner,

v.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Respondent.

On Petition for a Writ of Certiorari to the Court of Appeal of the State of California in and for the Second Appellate District

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BRIEF OF THE GOVERNMENT OF CANADA AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether the application of the corporate income apportionment formula, known as worldwide combined reporting, to domestic corporations with foreign parents violates the Foreign Commerce Clause of the United States Constitution, Article 1, Section 8, Clause 3.

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BRIEF OF THE GOVERNMENT OF CANADA AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE GOVERNMENT OF CANADA

Petitioner, Alcan Aluminum Corporation ("Alcan"), is a member of a multinational corporate group based in Montreal, Quebec, Canada and a U.S. subsidiary of a Canadian corporation, Alcan Aluminium Limited ("Limited"). The Alcan Petition makes it clear that Limited and its non-U.S. subsidiaries have no permanent establishments in California, yet they are adversely affected by Respondent Franchise Tax Board's ("FTB") application of worldwide combined reporting ("WWCR") to Alcan. Other multinational corporate groups based in Canada and elsewhere outside the United States, with which California has no jurisdictional link whatsoever, are similarly

affected by FTB's use of WWCR.[1] Thus, the taxation at issue in this Petition is different from the domestic taxation this Court has previously considered.[2] The taxation here is in reality of international rather than local concern. Canada shares that concern.

In the interest of preserving commerce between Canada and the United States,[3] eliminating the serious adverse consequences of WWCR for Canadian corporations, and ending the disruption to the international taxation framework caused by WWCR, Canada hereby submits this brief *amicus curiae* in support of Petitioner.[4]

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[1] See, for example, *amicus curiae* brief of the Government of the United Kingdom and *amici curiae* brief of the twelve Member States of the European Communities: Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain and the United Kingdom; and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland, filed in this Court in support of Petitioner in *Barclays Bank PLC v. Franchise Tax Board*, No. 92-1384 (April 22, 1993).

[2] *Container Corp. of America v. Franchise Tax Bd.* 463 U.S. 159 (1983).

[3] Canada and the United States have the largest bilateral trade and economic relationship in the world. In 1992, two-way trade was almost $184 (U.S.) billion. Canada accounted for approximately 21% of all U.S. exports, and more than 77% of Canada's exports went to the U.S. In that year, imports by Canada from California exceeded $5 (U.S.) billion, and Canadian exports to California were almost $5 (U.S.) billion. *Statistics Canada*, International Trade Division, 1993.

At the end of 1992, total United States investment in Canada amounted to $198.8 (U.S.) billion, representing about 47% of all foreign investment in Canada. Of this total, U.S. direct investment in Canada was approximately $68.7 (U.S.) billion, representing about 64% of all foreign direct investment in Canada. Canadian direct investment in the United States at the end of 1992 was more than $45.5 (U.S.) billion. *Statistics Canada*, Catalogue 67202, "Canada's International Investment Position," 1992.

[4] Petitioner and Respondent have consented to the filing of this brief *amicus curiae* in letters filed with the Clerk of this Court.

STATEMENT

Since 1983, when this Court reserved determination of the issue presented,[5] Alcan and Limited have been seeking relief in both Federal and state courts in the United States. From 1984 until 1990, Limited was involved in litigation with FTB over its use of WWCR in United States Federal Courts: the District Court for the Northern District of Illinois; the Court of Appeals for the Seventh Circuit; and this Supreme Court of the United States, which held that while Limited had standing as the sole stockholder of Alcan to challenge WWCR on foreign commerce clause grounds, the Tax Injunction Act barred the action.[6] In accordance with this Court's decision, Alcan resumed the litigation in California: in the Los Angeles County Superior Court; the Second Appellate District, Division Three of the Court of Appeal of the State of California; and the California Supreme Court, which denied its Petition for review in December 1992.

Canada and the other main trading partners of the United States, including the United Kingdom and the Member States of the European Communities, filed *amici curiae* briefs supporting Limited and Alcan. Other countries and their corporations have been involved in similar searches for a judicial resolution.[7] Canada and other members of the international community have continued to register by diplomatic channels their objection to FTB's intrusion into the international tax framework.[8] The con-

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[5] *Container Corp., supra* at 189, n. 26 and 195, n. 32.

[6] *Franchise Tax Board of California v. Alcan Aluminium, Ltd.*, 483 U.S. 331 (1990).

[7] For example, *Barclays Bank PLC v. Franchise Tax Board*, No. 92-1384 (1993); *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593 (CA9), cert. denied, 464 U.S. 1012 (1983); *EMI Ltd. v. Bennett*, 738 F.2d 994 (CA9), cert. denied, 469 U.S. 1073 (1984).

[8] September 26, 1980 Exchange of Letters between the Honourable Allan J. MacEachen, Deputy Prime Minister and Minister of Fi-

nance of Canada, and the Honourable G. William Miller, Secretary of the Treasury of the United States (September 26, 1980), with reference to The Convention Between the United States of America and Canada with Respect to Taxes on Income and Capital, 1984 C.T.S. 15, p. 64, I Tax Treaties (CCH) 1317MB; Diplomatic Note No. 692 from Canada to the United States, December 22, 1981; Diplomatic Note No. 245 from Canada to the United States, May 10, 1982; Diplomatic Note No. 283 from Canada to the United States, June 14, 1982; Letter of his Excellency, Allan Gotlieb, Canadian Ambassador to the United States, to the Honourable Donald T. Regan, United States Secretary of the Treasury, August 11, 1983; Letter of the Honourable Marc Lalonde, Minister of Finance of Canada, to the Honourable Donald T. Regan, Secretary of the Treasury of the United States, August 11, 1983; Letter of his Excellency, Allan Gotlieb, Canadian Ambassador to the United States, to the Honourable Donald T. Regan, United States Secretary of the Treasury, August 23, 1983; Letter of the Right Honourable Pierre Elliott Trudeau, Prime Minister of Canada, to his Excellency, Ronald Reagan, President of the United States, September 24, 1983; Diplomatic Note No. 481 from Canada to the United States, September 28, 1983; Diplomatic Note No. 338 from Canada to the United States, June 17, 1985; Letter of his Excellency, Allan Gotlieb, Canadian Ambassador to the United States, to the United States Secretary of State, Secretary of the Treasury, and Attorney General, September 30, 1987.

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troversy has been partially responsible for stalling some bilateral tax treaty negotiations with the United States.[9]

The "water's edge election" statute California enacted in 1986 and that became effective in 1988[10] has not eliminated the problems caused by FTB's continued reliance upon WWCR. Though corporations can now "elect" whether FTB can apply WWCR to them, they must pay a substantial fee for the "privilege" and contract with the FTB to be bound by that election for a rolling ten year period. Under this contract, corporations must also agree to accept burdensome information requirements to be imposed solely at the discretion of FTB. The contract also provides for a penalty—the reimposition of WWCR without any refund of the election fee—which

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from Embassy of Australia, November 7, 1983; Demarche No. 461.20-LJ/hu from Embassy of Switzerland, November 15, 1983; Demarche from the Republic of Germany, November 28, 1983; Demarche EA-14533 from Embassy of the Netherlands, December 21, 1983; Demarche from Belgium, President European Communities, supported by the Member States of the European Communities, the European Commission, and the Embassies of Australia, Japan, Canada, and Switzerland, January 1, 1984; Demarche from Embassy of Belgium, January 25, 1984; Aide-Memoire from Government of Japan, June 6, 1984; Demarche from Ireland, President European Communities, on behalf of the Member States of the European Communities, December 20, 1984; Demarche from the Commission of the European Communities and the Embassy of Luxembourg, August 8, 1985; Demarche from the Member States of the European Communities and the Commission of the European Communities, August 30, 1985; Letter of his Excellency, Julian Santamaria, Ambassador of Spain, on behalf of the Member States of the European Communities, to the Honourable James A. Baker III, United States Secretary of State, June 30, 1989; Demarche from the United Kingdom, President European Communities, on behalf of the Member States of the European Communities, July 22, 1992.

[9] January 30, 1986 letter of United States Secretary of State George P. Shultz to the Governor of California. (Relevant text of letter set out in Footnote 26, *infra.*)

[10] California Revenue and Taxation Code § 25110.

can be imposed by the FTB without any provision for judicial review.

United States Assistant Secretary of the Treasury for Tax Policy J. Roger Mentz explained in testimony before the United States Senate Committee on Finance that the Federal Government had: "a number of serious policy concerns with the California legislation" including:

> In our view, a foreign corporation's ability to avoid being taxed by a state on its foreign income should not be conditioned on payment of a substantial election fee.[11]

ARGUMENT

I. THE APPLICATION OF WORLDWIDE COMBINED REPORTING TO DOMESTIC SUBSIDIARIES OF FOREIGN CORPORATIONS CREATES AN ENHANCED RISK OF MULTIPLE TAXATION.

The internationally accepted norm for allocating income for tax purposes is arm's length separate accounting ("AL/SA"). Under AL/SA, the income of each member of a corporate group is computed by separate accounting on the basis that each member of the group must deal with the other as if it was a wholly separate entity owned by unrelated interests. This method follows model conventions for the avoidance of double taxation developed by the Organization for Economic Cooperation and Development ("OECD")[12] and the United Nations, both of which expressly rejected formula

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[11] *Hearings on S. 1974 before the Senate Committee on Finance Subcommittee on Taxation and Debt Management*, 99th Cong., 2d Sess. (September 29, 1986), (statement of J. Roger Mentz, Assistant Secretary of the Treasury for Tax Policy).

[12] The members of the OECD are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States of America.

apportionment in favor of arm's length allocation.[13] Furthermore, Canada notes with satisfaction that the United States Supreme Court has recognized there is a "serious divergence in the taxing schemes adopted by California and the foreign taxing authorities" and that the method preferred by the United States Government and adopted by "foreign taxing authorities is consistent with accepted international practice." [14]

The principles of AL/SA have been adopted by the nations of the world in their double taxation treaties.[15] As a result, a considerable degree of harmonization between

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[13] United Nations Model Double Taxation Convention Between Developed and Developing Countries, arts. 5(8), 7(2), 9(1), U.N. Doc. ST/WSA/102 (1980); Report of the OECD Comm. on Fiscal Affairs, Model Double Taxation Convention on Income and on Capital, arts. 5(7), 7(2), 9(1) (1977).

[14] *Container Corp., supra* at 187.

[15] The use of arm's length separate accounting and the requirement of a permanent establishment are contained in all of the 58 bilateral income tax treaties to which Canada is currently a party, including the Convention between Canada and the United States of America with Respect to Taxes on Income and Capital signed at Washington on September 26, 1980, 1984 C.T.S. 15, T.I.A.S. No. 11087.

The requirement of the use of AL/SA has been contained in every tax treaty to which the United States has been a party since the first such treaty, which was signed with France April 27, 1932. 164 LTS 211, TS 885, 49 Stat. 3145, Article IV.

All of the U.S. treaties for the prevention of double taxation contain an absolute prohibition on U.S. taxation of the profits of a foreign corporation that does not have a permanent establishment in the U.S. Article VII of the United States-Canada Income Tax Convention exemplifies this prohibition:

> The business profits of a resident of a Contracting State shall be taxable only in that state unless the resident carries on business in the other Contracting State through a permanent establishment situated therein. If the resident carries on, or has carried on, business as aforesaid, the business profits of the resident may be taxed in the other State but only on so much of them as is attributable to that permanent establishment.

their bilateral tax conventions has been achieved, to the benefit of taxpayers and national governments. This framework of understanding and cooperation on taxation matters has contributed to the significant growth of trade and investment since World War II.

Applying WWCR, FTB considers separate foreign and domestic corporations part of a multicorporate group as one, and subjects all their worldwide income to tax as one "unitary" corporation, regardless of whether it is taxable under the Internal Revenue Code or applicable treaty, or has been attributed to and taxed in foreign jurisdictions. The group's combined income is apportioned between California and the rest of the world on the basis of an arbitrary formula composed of the ratio of payroll, sales, and property of the group in California compared to the world.

Canada notes that the United States Supreme Court has acknowledged the double taxation that results from the serious divergence between WWCR and the international norm.[16] It is difficult to imagine a more "serious divergence" from the international taxation framework than WWCR. To Canada's knowledge, of all the countries in the world and their political subdivisions, only California and North Dakota apply WWCR to foreign based multicorporate groups.[17] Double taxation occurs because WWCR employs entirely different principles for deciding where income is earned. The double taxation produced can only be resolved if WWCR is required to give way to AL/SA.[18]

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[16] *Container Corp., supra* at 187.

[17] Montana applies WWCR only to domestic based multicorporate groups.

[18] Any multiple taxation or undertaxation that occurs from any differences in the allocation of income and expenses among tax jurisdictions employing AL/SA, being those of inconsistent applications of the same principle, can be eliminated and resolved through international negotiation and double taxation conventions.

Double taxation is also the consequence of the severe distortions that ensue when diverse economic conditions throughout the world are incorporated into the WWCR formula.[19] WWCR assumes that a dollar spent on payroll or property, or a dollar of sales made in one tax jurisdiction produces roughly the same amount of taxable income as a dollar so spent, or sale made, in another tax jurisdiction. Common sense and realities of the marketplace defeat that assumption.

It would be equally challenging to present a more extreme example of double taxation than the Petitioner describes.[20] When FTB, through the use of WWCR, combined the loss of Alcan with the income of Limited and its non-U.S. subsidiaries, the FTB levied assessments totalling $1,720,615.94 (U.S.).[21] Clearly income not earned in California by Alcan was subjected to California's taxation. Obviously, that income was earned outside of California's taxing jurisdiction, and just as plainly, subject to taxation where it was actually earned.

II. THE USE OF WWCR PREVENTS THE UNITED STATES GOVERNMENT FROM SPEAKING WITH ONE VOICE WHEN REGULATING COMMERCIAL RELATIONS WITH FOREIGN GOVERNMENTS.

The use of WWCR contradicts the policy of the United States Government. The *amicus curiae* brief of

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[19] *State Taxation of Foreign Source Income: Hearings on H.R. 5076 before the House Committee on Ways and Means, 96th Cong., 2d Sess. 7 (1980)*, (statement of Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy).

[20] Petition for Writ of Certiorari, 19-22.

[21] *Alcan Aluminum Corporation v. Franchise Tax Board of the State of California*, No. B065648 (Court of Appeal of the State of California, Second Appellate District, Division Three), unpublished opinion p. 2 (Nov. 11, 1992). Petition for Writ of Certiorari, A2.

the United States filed below succinctly states the United States Government's position:

> It is the position of the United States that California's worldwide unitary income allocation method of taxation may not constitutionally be applied to the taxpayer (plaintiff-appellant) without impairing the ability of the United States to speak with one voice in conducting and controlling foreign relations and international commerce.[22]

As discussed above, the use of AL/SA has been required by every tax treaty to which the United States has been a party since the first such treaty signed with France on April 27, 1932. The United States Senate has ratified all of those treaties and the United States Congress included that requirement in Internal Revenue Code § 482,[23] the predecessor to which was first enacted in the Revenue Act of 1928.

The disruption to the United States' ability to speak with one voice, which results from it and the rest of the world having one international corporate taxation system and California having another incompatible one, is evident:

> A failure to bring this development to a halt and to eliminate the international incidence of unitary taxation might lead the international community to conclude that the United States has ceased to speak with one voice and thus is no longer contributing to the international tax order toward which the United

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[22] Brief *Amicus Curiae* of the United States in Support of Plaintiff and Appellant Alcan Aluminum Corporation, *Alcan Aluminum Corporation v. Franchise Tax Board of the State of California*, Court of Appeal of the State of California, Second Appellate District, p. 2, (April 1992).

[23] 26 U.S.C. § 482.

States, Germany and other nations have worked for so many years.[24]

If left to stand, the decision of the California courts below will affirm the impairment of the United States to speak with one voice. Canada and other trading partners of the United States would not be able to rely upon the United States Government's official declarations of national policy in the area of foreign commerce if such policy were to be ultimately determined by a state court's interpretation of the "inaction" of Congress.

No approval of FTB's use of WWCR can be inferred from the fact that bilateral tax treaties in general, and the tax treaties to which Canada and the United States are a party specifically, do not explicitly prohibit political subdivisions from using WWCR.[25] In International Law, Sovereign States have the capacity to become parties to treaties, not their political subdivisions, be they provinces or states. Historically, bilateral conventions have not set standards for the taxes of political subdivisions, because it has been considered that once a treaty has been entered into, in conformity with an international norm, a political subdivision would not presume to devise another method of taxing international income earned outside its jurisdiction by members of multicorporate groups with no permanent establishment there. As discussed above, such other methods occur nowhere outside of the two states of the United States.

The repeated diplomatic expressions of disapproval of WWCR by the treaty partners of the United States contradict any claim that their treaties with the United States

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[24] Memorandum to the United States Department of the Treasury on the Issue of State Taxation by Worldwide Combination and Formula Apportionment "Unitary Taxation," Federal Republic of Germany, Federal Ministry of Finance, p. 5, (Nov. 28, 1983).

[25] Many of the bilateral tax treaties to which the United States and Canada are a party predate the use of WWCR.

somehow "approve" of its use.[26] Numerous examples of the official expressions of disapproval by Canada and other trading partners of the United States are detailed above. Most recently, the British Chancellor of the Exchequer the Right Honourable Norman Lamont announced that the British Government will have to take retaliatory measures in relation to United States-based companies if there is not a satisfactory resolution of the problems caused by the FTB's use of WWCR by the end of 1993.[27]

Canada, like the other main trading partners of the United States, questions the utility and effectiveness of double taxation conventions with the United States when the application of WWCR by a few states, such as California, clearly frustrates the spirit of the convention and impairs the benefits accruing to Canadian nationals conducting commercial activities in the territory of the United States. Most recently, Canada and other coun-

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[26] United States Secretary of State George P. Shultz in his January 30, 1986 letter to the Governor of California summarized the international expressions of offense over the use of WWCR:

> The Department of State has received diplomatic notes complaining about state use of the worldwide unitary method of taxation from virtually every developed country in the world. The unitary issue has been partially responsible for stalling some bilateral tax treaty negotiations.
>
> Most seriously, the U.K. Parliament, in July, 1985, unanimously adopted anti-unitary retaliatory legislation permitting the U.K. government to deny, on a unilateral basis and retroactive to April, 1985, a very valuable benefit of the U.S.-U.K. treaty for U.S. corporations operating in worldwide unitary states.

Secretary of State Shultz was referring to Section 54 of and Schedule 13 to the Finance Act of 1985—now reenacted as Section 812-815 of the Income and Corporations Taxes Act 1988.

[27] House of Commons Official Report, *Parliamentary Debates* (Hansard), Column 528 of the Official Record of 13 May, 1993, Vol. 224, No. 178.

tries have pointed out that determination of the issue presented here will influence their future bilateral treaty negotiations with the United States.[28]

CONCLUSION

Canada is concerned about FTB's continued use of WWCR because, *inter alia*: Canada-based multicorporate groups are adversely affected; double taxation of their income results; WWCR conflicts with the international framework established to avoid such double taxation; and the ability to rely upon the United States Government to speak with one voice for the nation is put in doubt. Numerous other countries have expressed these same concerns.

It behooves this Court as the appropriate agency of the United States to resolve as it can now do the legal issue of the validity of the application of WWCR to domestic corporations with foreign parents. Canada notes that all the elements that this Court has specified as necessary to determine the issue are present in this case: (1) the serious divergence between WWCR and the established tax framework presents an automatic asymmetry; (2) the incidence of the tax falls on a domestic corporation owned by a Canada parent corporation; and (3) the concern over FTB's use of WWCR is international, not local.

In addition, this case presents a clear example of the double taxation that inherently results from the application of WWCR. There also can be no doubt that United States foreign policy is impaired. The *amicus curiae* briefs submitted by the United States at every level below in

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[28] *Amici curiae* brief of the twelve Member States of the European Communities: Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom; and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland, filed in support of Petitioner, p. 2., *Barclays Bank PLC v. Franchise Tax Board*, No. 92-1384 (1993).

this case and *Barclays Bank, PLC v. Franchise Tax Board,* No. 92-1384 confirm it. The major trading partners of the United States have most recently expressed, in briefs filed with this Court, their concern over the effect of that impairment upon their future economic and commercial relations with the United States.[29]

The Government of Canada asks that Petitioner's Petition for a Writ of Certiorari be granted.

Respectfully submitted,

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Dated: June 2, 1993

[29] See, for example: *amicus curiae* brief of the Government of the United Kingdom and *amici curiae* brief of the twelve Member States of the European Communities: Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom; and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland, filed in support of Petitioner in *Barclays Bank PLC v. Franchise Tax Board,* No. 92-1384 (1993).